Solution 6.1

a) Calculations

Current taxation (and deferred taxation adjustment)		30%	
Accounting profit	100 000		
Permanent differences:			
- capital profits (exempt income)	(50 000)		
+ donations (non-deductible expenses)	30 000		
Taxable accounting profits	80 000	24 000	Dr Tax expense
Temporary differences:			
- expenses prepaid closing balance	(40 000)	12 000	Cr Deferred tax
Taxable income	40 000	12 000	Cr CTP

Deferred taxation calculation (Balance sheet approach)	Carrying amount	Tax base	Temporary difference	Deferred tax	Balance/ adjustment
Balance: 1 March 20X0	0	0	0	0	
Adjustment				(12 000)	dr TE; cr DTL
Balance: 28 February 20X1	40 000	0	(40 000)	(12 000)	L

b) Ledger-accounts

Taxation

Description	*C*	*Description*	*C*
Current tax payable/ receivable	12 000		
Deferred tax	12 000		
		Profit & Loss	24 000
	24 000		24 000

Current tax payable/ receivable

Description	*C*	*Description*	*C*
		Taxation	12 000
Balance c/d	12 000		
	12 000		12 000
		Balance b/d	12 000

Deferred tax

Description	*C*	*Description*	*C*
		Taxation	12 000
Balance c/d	12 000		
	12 000		12 000
		Balance b/d	12 000

Solution 6.1 continued …

c) Disclosure

LOOK LIMITED
EXTRACT FROM NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 28 FEBRUARY 20X1

		20X1 C
3. Taxation		
Normal tax		
Current tax		12 000
Deferred tax		12 000
Income tax expense		24 000

Tax rate reconciliation:	**C**	**%**
Tax effects of:		
Profit before tax / applicable rate (100 000 x 30%)	30 000	30
Exempt capital profits (50 000 x 30%)	(15 000)	(15)
Non-deductible expenses (30 000 x 30%)	9 000	9
Income tax expense / effective rate	24 000	24

d) Journals

GENERAL JOURNAL

	Debit	**Credit**
Tax expense	12 000	
Current tax payable: normal tax		12 000
Current normal taxation estimated for 20X1		
Tax expense	12 000	
Deferred taxation: normal tax		12 000
Deferred normal taxation estimated for 20X1		

e) Statement of comprehensive income disclosure

LOOK LIMITED
EXTRACT FROM STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 28 FEBRUARY 20X1

	Note	**20X1 C**
Profit before tax		100 000
Income tax expense	3	(24 000)
Profit for the period		76 000
Other comprehensive income		-
Total comprehensive income		76 000

Solution 6.1 continued …

f) Statement of financial position disclosure

LOOK LIMITED
EXTRACTS FROM STATEMENT OF FINANCIAL POSITION
AS AT 28 FEBRUARY 20X1

	Note	20X1
EQUITY AND LIABILITIES		**C**
Non-current liabilities		
Deferred taxation		12 000
Current liabilities		
Current tax payable: Normal taxation		12 000

Solution 6.2

a) Journals

	Debit	Credit
20X7		
Tax expense	100 000	
Current tax payable: normal tax		100 000
Current normal taxation estimated for 20X7		
Tax expense	800	
Deferred taxation: normal tax		800
Deferred normal taxation adjustment estimated for 20X7		
Depreciation: equipment	48 000	
Accumulated depreciation: equipment		48 000
Depreciation on equipment: 20X7		
20X8		
Tax expense	116 000	
Current tax payable: normal tax		116 000
Current normal taxation estimated for 20X8		
Deferred taxation: normal tax	3 200	
Tax expense		3 200
Deferred normal taxation adjustment estimated for 20X8		
Current tax payable: normal tax	100 000	
Bank		100 000
Payment of current normal taxation charged for 20X7		
Depreciation: equipment	48 000	
Accumulated depreciation: equipment		48 000
Depreciation on equipment: 20X8		

b) Disclosure

EYE LIMITED
EXTRACT FROM STATEMENT OF FINANCIAL POSITION
AT 30 JUNE 20X8

	Note	20X8 C	20X7 C
Non-current assets			
Equipment		288 000	336 000
Non-current liabilities			
Deferred tax	15	8 752	11 952
Current liabilities			
Current tax payable		116 000	100 000

EYE LIMITED
EXTRACT FROM STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED 30 JUNE 20X8

	Note	20X8 C	20X7 C
Profit before tax	10	282 000	252 000
Income tax expense	11	(112 800)	(100 800)
Profit for the period		169 200	151 200
Other comprehensive income		-	-
Total comprehensive income		169 200	151 200-

Solution 6.2 continued …

EYE LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED 30 JUNE 20X8

	20X8 C	20X7 C

1. Accounting policies

1.1 Statement of compliance

These financial statements have been prepared in accordance with the approved accounting standards as applicable in Pakistan. Approved accounting standards comprise of such International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board as are notified under the Companies Ordinance, 198, provisions of and directives issued by under the Companies Ordinance, 1984. In case the requirements differ, the provisions or directives of the Companies Ordinance, 1984 shall prevail.

1.2 Basis of preparation

The financial statements have been prepared in the historical cost basis except for the revaluation of certain non-current assets. These policies are consistent in all material respects with these applied in the previous years.

1.3 Equipment

Equipment held for the use in the production or supply of goods or services, or for administration purposes, are stated in the statement of financial position at their costs less any subsequent accumulated depreciation and subsequent impairment losses.

Depreciation is charged so as to write off the cost or valuation of assets, over their estimated useful lives using the straight line method. The estimated useful lives, residual values and depreciation method are reviewed at each year end, with the effect of any changes in estimate accounted for in a prospective basis.

1.4 Deferred taxation

Deferred tax is provided using the balance sheet liability method, on all the temporary differences at the balance sheet date between the tax base of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax asset are recognized for all deductible temporary differences, carry forward of unused tax losses, to the extent that is probable that future taxable profit will be available against which the deductible temporary difference, unused tax losses and tax credits can be utilized.

Carrying amount of deferred tax asset is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that the related tax benefit will be realized. Deferred taxis calculated at the rates that are expected to apply to the period when differences reverse based on the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.

10. Profit before tax is arrived at after charging:

Depreciation	48 000	48 000

11. Taxation

Normal tax		
Current tax	116 000	100 000
Deferred tax	(3 200)	800
Income tax expense	112 800	100 800

15. Deferred taxation liability

Deferred tax was caused by temporary differences relating to:

• Equipment	8 752	11 952

Solution 6.2 continued …

Workings

W1. Current normal tax	20X8	40%		20X7	40%	
Profit before tax	282 000	112 800	Dr TE	252 000	100 800	Dr TE
Temporary differences	8 000	3 200	Dr DT	(2 000)	800	Cr DT
Depreciation	48 000			48 000		
Tax depreciation	(40 000)			(50 000)		
Taxable profit	290 000	116 000	Cr CTP	250 000	100 000	Cr CTP

W2. Deferred tax: property, plant and equipment		Carrying amount	Tax base	Temporary difference	Deferred tax bal/ adj	
30/06/X6	Balance	384 000	356 120	(27 880)	(11 152)	L
		(48 000)	(50 000)	(2 000)	(800)	Cr
30/06/X7	Balance	336 000	306 120	(29 880)	(11 952)	L
		(48 000)	(40 000)	8 000	3 200	Dr
30/06/X8	Balance	288 000	266 120	(21 880)	(8 752)	L

Solution 6.3

a) Calculation of profit before tax	Total	20X2	20X1
Cash received		110 000	10 000
- cash received in advance (closing balance)		(0)	(10 000)
+ cash received in advance (opening balance) (now recognised)		10 000	0
Profit before tax	120 000	120 000	0

b) Calculation of taxable profits and current normal tax			
Profit before tax (see (a) above)		120 000	0
+ cash received in advance (closing balance)		0	10 000
- cash received in advance (opening balance) (taxed in prior year)		(10 000)	(0)
Taxable income	120 000	110 000	10 000
Current tax at 30% of taxable profits	36 000	33 000	3 000

c) Calculation of actual effective rate of tax over the 2 years			
Taxation	36 000	33 000	3 000
Profit before tax	120 000	120 000	0
Effective rate of tax (the effective rate of tax is 30% over the two years but each year the effective rate appears distorted!)	30%	28%	Not possible

Comment:
The reason for the distortion shown above (i.e. the difference between the effective tax rate and the standard tax rate of 30%) is that the tax on the C10 000 rent received in 20X1 is recognised in 20X1 whereas this rent income is only recognised in 20X2. If one recognised the tax expense in the same period that the related income was recognised (i.e. both recognised in 20X2), then matching would be achieved. See below:

Profit before tax		120 000	0
Tax (120 000 x 30%) (0 x 30%) (current and deferred!)		(36 000)	0
Profit after tax	84 000	84 000	0
Effective rate of tax per year		30%	n/a

The profit after tax and the effective rate of tax makes more sense now that the taxes have been matched to the profits.

d) Ledger-accounts

Taxation			
Description	***C***	***Description***	***C***
20X1			
CTP [1]	3 000	Deferred tax [2]	3 000
20X2			
CTP [3]	33 000		
Deferred tax [4]	3 000		
	36 000		

Current tax payable/ receivable			
Description	***C***	***Description***	***C***
		20X1	
		Taxation [1]	3 000
		20X2	
		Taxation [3]	33 000

Solution 6.3 continued …

Deferred tax			
Description	***C***	***Description***	***C***
20X1		**20X2**	
Taxation [2]	3 000	Taxation [4]	3 000

1) Current tax owing to the tax authorities in 20X1 must be recognised as a liability.
2) The tax expense caused by income that will only be recognised in the future should be deferred and recognised in the future instead. This tax is treated as a deferred tax asset and is much the same as a prepaid expense in that it is tax to be paid before it is incurred (the accountant believes that this tax is only incurred once the related income is earned).
3) Current tax owing to the tax authorities in 20X2 must be recognised as a liability.
4) The tax expense, the recognition of which was previously deferred to a future year (i.e. deferred tax), should now be recognised since the income has now been recognised (i.e. the deferred tax asset balance should now be reversed and recognised as an expense).

e) Disclosure

PHOBIE LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 20X2

4. Taxation	**20X2 C**	**20X1 C**
Normal tax		
Current tax	33 000	3 000
Deferred tax	3 000	(3 000)
Income tax expense	36 000	0

f) Journals

	Debit	**Credit**
20X1		
Bank	10 000	
Rent income received in advance		10 000
Rent received		
Tax expense	3 000	
Current tax payable: normal taxation		3 000
Current normal taxation estimated for 20X1		
Deferred taxation: normal	3 000	
Tax expense		3 000
Deferred normal taxation adjustment estimated for 20X1		
20X2		
Bank	110 000	
Rent income		110 000
Rent received		
Rent income received in advance	10 000	
Rent income		10 000
Rent received in advance opening balance reversed in 20X2		
Tax expense	33 000	
Current tax payable: normal tax		33 000
Current normal taxation estimated for 20X2		
Tax expense	3 000	
Deferred taxation: normal tax		3 000

Deferred normal taxation balance reversed in 20X2

Solution 6.4

a) Discussion

Definition of a liability
- A present obligation
- Of the entity
- As a result of a past event
- The settlement of which is expected to result in an outflow of future economic benefits.

Definition of an expense
- Decrease in economic benefits
- During the accounting period
- In the form of decrease in assets or increase in liabilities resulting in a decrease in equity
- Other than through a distribution to equity participants.

Recognition criteria
- A reliable estimate must be possible.
- The outflow of future economic benefits must be probable.

Discussion: liability
- The event is the earning/ receiving of the taxable profits: since the profits on which the tax is calculated were earned/ received before 31 December 20X3, the event is a past event.
- Since there is a past event, there is a present obligation as at 31 December 20X3.
- Since the taxable profits were earned by the entity, the tax thereon is a legal obligation of the entity.
- The settlement of the obligation will result in an outflow of cash.

Discussion: recognition criteria
- A reliable estimate is possible since the Income Tax Ordinance is available to the public to use in the estimate thereof/ the auditors, who are professionals in this area, have already calculated the estimated tax.
- The outflow is probable since it has either already been pre-paid via the provisional payment system/ or will have to be paid since it is a legislative requirement!

Discussion: expense
- The decrease in economic benefits is the tax outflow expected in relation to the profits made (i.e. a decrease in profits).
- The profits arose in 20X3 and therefore the tax arose in 20X3 and thus it is a decrease in economic benefits during the accounting period 20X3.
- Since there has been an increase in liabilities without an equal increase in assets, equity will decrease.
- The tax payable on the profits is not a distribution to equity participants.

Conclusion
Since both the liability and expense definitions and the related recognition criteria have been met, the current tax liability and related tax expense should be processed.

Solution 6.4 continued …

b) Journals

	Debit	Credit
Tax expense	80 000	
Current tax payable (L)		80 000
Current normal tax for 20X3		
Tax expense	7 000	
Current tax payable (L)		7 000
Under-provision of current normal tax in 20X2		
Tax expense	10 000	
Deferred tax (L)		10 000
Deferred tax adjustment for 20X3: 60 000 (L) – 50 000 (L)		

Solution 6.5

a) Deferred tax working paper

	Carrying amount	Tax base	Temporary difference	Deferred tax	
Property, plant & equipment:					
Balance – 28/02/20X1	145 000	115 000	(30 000)	(9 000)	L
Movement				(1 500)	Cr DT; Dr TE
Balance – 28/02/20X2	120 000 (1)	85 000	(35 000)	(10 500)	L
Rent received in advance:					
Balance – 28/02/20X1	(2 000)	0	2 000	600	A
Movement				900	Dr DT; Cr TE
Balance – 28/02/20X2	(5 000)	0	5 000	1 500	A
Interest income receivable:					
Balance – 28/02/20X1	0	0	0	0	
Movement				0	
Balance – 28/02/20X2	20 000	20 000	0	0	

(1) 115 000 – 30 000 = 85 000

Deferred tax summary	Property, plant and equipment	Rent received in advance	Income receivable	Total	
Balance – 28/02/20X1	(9 000)	600	0	(8 400)	L
Movement *(balancing)*	(1 500)	900	0	(600)	Cr DT; Dr TE
Balance – 28/02/20X2	(10 500)	1 500	0	(9 000)	L

b) Current normal tax calculation

		20X2 C	X 30%	
Profit before tax		100 000		
Permanent differences		0		
		100 000	30 000	Normal tax
Movement in temporary differences		(2 000)	600	Deferred tax
Add depreciation	*145 000 – 120 000*	25 000		
Less tax depreciation	*Given*	(30 000)		
Add rent received in advance c/ balance	*Will be taxed in 20X2*	5 000		
Less rent received in advance o/ balance	*Was taxed in 20X1*	(2 000)		
Taxable profits		98 000	29 400	Current tax

Solution 6.5 continued …

c) Ledger accounts

Taxation			
Description	***C***	***Description***	***C***
Current tax payable/ receivable [4]	29 400	Profit and loss	30 000
Deferred tax [3]	600		
	30 000		30 000

Deferred tax			
Description	***C***	***Description***	***C***
		Balance b/f [1]	8 400
Balance c/f [2]	9 000	Taxation [3]	600
	9 000		9 000
		Balance b/f [2]	9 000

Current tax payable/ receivable			
Description	***C***	***Description***	***C***
		Balance b/f	10 000
Balance c/f	39 400	Taxation [4]	29 400
	39 400		39 400
		Balance b/f	39 400

1) 9 000 – 600: see workings in part (a): (opening balance of deferred tax)
2) 10 500 – 1 500: see workings in part (a): (closing balance of deferred tax)
3) 9 000 – 8 400: see workings in part (a): (deferred tax adjustment)
4) Current tax for 20X2

d) Disclosure

BLUE CHEESE LIMITED
EXTRACT FROM STATEMENT OF FINANCIAL POSITION
AS AT 28 FEBRUARY 20X2

	Notes	20X2 C	20X1 C
Non-current assets			
Property, plant and equipment		120 000	145 000
Current assets			
Interest receivable		20 000	0
Non-current liabilities			
Deferred tax	10	9 000	8 400
Current liabilities			
Current tax payable		39 400	10 000
Income received in advance		5 000	2 000

e) Deferred tax note disclosure

BLUE CHEESE LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBE 20X2

	20X2 C	20X1 C
10. Deferred taxation asset / (liability)		
The deferred tax balance comprises temporary differences caused by:		
• Property, plant and equipment	(10 500)	(9 000)
• Income received in advance	1 500	600
	(9 000)	(8 400)

Solution 6.5 continued …

f) Discussion

Plant and equipment

- The carrying amount of the plant and equipment represents the amount that will be recovered in the form of economic benefits that will flow to the entity in future periods.

- The tax base of the plant and equipment is the amount that will be deductible for tax purposes against the future taxable economic benefits.

- As the carrying amount of the plant and equipment exceeds its tax base, the amount of the taxable economic benefits will exceed the amount that will be allowed as a deduction for tax purposes. This difference is a taxable temporary difference and the obligation to pay the resulting income taxes in future periods is recognised as a deferred tax liability.

Rent received in advance

- The carrying amount of the rent received in advance represents the obligation to provide services in future periods.

- The tax base of the rent received in advance is the carrying amount of the liability, less any amount of the revenue that will not be taxable in future periods. In other words, the tax base represents the portion of the future economic benefits (past cash receipt) that will be taxable in a future period.

- As the rent received in advance was not recognised as income for accounting purposes but was taxed in the current period, the tax base is zero (C5 000 – C5 000) (i.e. no portion of the income received in advance account will be taxable in the future). This gives rise to a deductible temporary difference and the tax 'pre-paid' is a deferred tax asset.

Interest income receivable

- The carrying amount of the interest income receivable represents the amount that will be recovered in the form of economic benefits that will flow to the entity in future periods.

- The tax base of interest income receivable is equal to its carrying amount if the economic benefits will not be taxable in future periods. Since all the interest income is taxed in the current year, no portion of the amount receivable will be taxed in the future: the tax base is therefore equal to its carrying amount (carrying amount: 20 000 – portion to be taxed in the future: 0).

- The tax authority taxes interest income on accrual basis and thus the interest income receivable is taxed in the current year (year of accrual). The accountant recognises income in the same year (the year of accrual). There is thus no temporary difference and no deferred tax.

Solution 6.6

a) Deferred tax calculation

Deferred tax computation	CA	TB	TD	DT	DT A/ L or DT adjustment
Property, plant and equipment					
Balance - 1/1/20X3	355 000	290 000	(65 000)	(19 500)	DTL
Depreciation/ tax depreciation	(35 000)	(25 000)	10 000	3 000	Dr DT; Cr TE
Balance - 31/12/20X3	320 000	265 000	(55 000)	(16 500)	DTL
Year-end accruals					
Balance - 1/1/20X3	(15 000)	0	15 000	4 500	DTA
- Income received in advance	(15 000)	0	15 000	4 500	
- Expenses prepaid	0	0	0	0	
Movement				900	Dr DT; Cr TE
Balance - 31/12/20X3	(18 000)	0	18 000	5 400	DTA
- Income received in advance	(28 000)	0	28 000	8 400	
- Expenses prepaid	10 000	0	(10 000)	(3 000)	
Total deferred tax balance at	***Calculations:***			**C**	
- 1/1/20X3	*19 500 (L) - 4 500 (A) + 0*			(15 000)	DTL
- 31/12/20X3	*16 500 (L) - 8 400 (A) + 3 000 (L)*			(11 100)	DTL

b) Calculation of current normal income tax

Current tax computation			
Profit before tax	300 000		
Adjust for permanent differences			
Less dividend income	(5 000)		
Taxable accounting profits	295 000	88 500	Dr TE
Adjust for movement in temporary differences	13 000	3 900	Dr DT
Add depreciation	35 000		
Less tax depreciation	(25 000)		
Add income received in advance closing balance	28 000		
Less income received in advance opening balance	(15 000)		
Less expenses prepaid closing balance	(10 000)		
Taxable profit	308 000	92 400	Cr CTP
Add: Tax on dividend income @ 10%	5 000	500	
		92 900	

Solution 6.6 continued . . .

c) Journal entries

	Debit	Credit
Tax expense	92 900	
Current tax payable		92 900
Current normal income tax for 20X3		
Deferred taxation	3 900	
Tax expense		3 900
Deferred normal income tax adjustment for 20X3		

d) Disclosure

FISH LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBE 20X3

	20X3 C	20X2 C
6. Deferred taxation asset/ (liability)		
The deferred tax balance is caused by temporary differences relating to:		
• Property, plant and equipment	(16 500)	(19 500)
• Expenses prepaid	(3 000)	0
• Income received in advance	8 400	4 500
	(11 100)	(15 000)

Solution 6.7

Part A

a) Calculating the taxable profits and current tax	20X3	20X2	20X1
	C	C	C
Profit before taxation and depreciation (given)	200 000	200 000	200 000
Depreciation:			
• First plant *(20X1, 20X2 & 20X3: 200 000 x 20%)*	(40 000)	(40 000)	(40 000)
• Second plant *(20X2 & 20X3: 500 000 x 20%)*	(100 000)	(100 000)	0
Profit before taxation	60 000	60 000	160 000
Adjust for permanent differences:	0	0	0
Taxable accounting profits	60 000	60 000	160 000
Adjust for temporary differences:			
+ depreciation	140 000	140 000	40 000
- tax depreciation: first plant *(20X1, 20X2 & 20X3: 200 000 / 4 yrs)*	(50 000)	(50 000)	(50 000)
- tax depreciation: second plant *(20X2 & 20X3: 500 000 / 4 yrs)*	(125 000)	(125 000)	0
Taxable profits	25 000	25 000	150 000
Tax rate	35%	35%	35%
Current tax	8 750	8 750	52 500

b) Calculation of deferred taxation using the income statement approach

Current tax *(taxable profits x 35%)*	8 750	8 750	52 500
Tax expense *(taxable accounting profits x 35%)*	21 000	21 000	56 000
Deferred tax charge *(movement in temporary differences x 35%)*	12 250	12 250	3 500

Summary of deferred tax effect on deferred tax in the statement of financial position (not required)

1/1/20X1	Opening balance	0	Given
20X1	Deferred tax charge (calculation b)	3 500	Cr DTL; Dr TE
1/1/20X2	Opening balance at 35%	3 500	Liability
20X2	Deferred tax charge (calculation b)	12 250	Cr DTL; Dr TE
1/1/20X3	Opening balance at 35%	15 750	Liability
20X3	Deferred tax charge (calculation b)	12 250	Cr DTL; Dr TE
31/12/20X3	Closing balance at 35%	28 000	Liability

c) Current and deferred tax journals		20X3	20X2	20X1
		Dr/ (Cr)	Dr/ (Cr)	Dr/ (Cr)
01-Jan	Tax expense	8 750	8 750	52 500
	Current tax payable (liability)	(8 750)	(8 750)	(52 500)
	Recording estimated current taxation owing			
31-Dec	Tax expense/ (income)	12 250	12 250	3 500
	Deferred tax asset/(liability)	(12 250)	(12 250)	(3 500)
	Recording current year's deferred tax charge			

Solution 6.7 continued …

Part A continued …

d) Calculation of deferred tax using the balance sheet approach

		Carrying amount	Tax base	Temporary differences	Deferred taxation	
1.1.20X1	Opening balance	0	0	0	0	
	First plant - cost	200 000	200 000	0	0	
30.6.20X1	Second plant - cost	500 000	500 000	0	0	
	Depreciation	(40 000)	(50 000)	(10 000)	(3 500)	Dr TE Cr DT
31.12.20X1	Balance at 35%	660 000	650 000	(10 000)	(3 500)	Liability
	Depreciation - first plant	(40 000)	(50 000)	(10 000)	(3 500)	Dr TE Cr DT
	Depreciation - second plant	(100 000)	(125 000)	(25 000)	(8 750)	Dr TE Cr DT
31.12.20X2	Balance at 35%	520 000	475 000	(45 000)	(15 750)	Liability
	Depreciation - first plant	(40 000)	(50 000)	(10 000)	(3 500)	Dr TE Cr DT
	Depreciation - second plant	(100 000)	(125 000)	(25 000)	(8 750)	Dr TE Cr DT
31.12.20X3	Balance at 35%	380 000	300 000	(80 000)	(28 000)	Liability

Solution 6.7 continued …

Part B

a) Calculating the taxable profits and current tax	20X3 C	20X2 C	20X1 C
Profit before taxation and depreciation (given)	200 000	200 000	200 000
Depreciation:			
• First plant *(20X1, 20X2 & 20X3: 200 000 x 30%)*	(40 000)	(40 000)	(40 000)
• Second plant *(20X2 & 20X3: 500 000 x 20%)*	(100 000)	(100 000)	0
Profit before taxation	60 000	60 000	160 000
Adjust for permanent differences:	0	0	0
Taxable accounting profits	60 000	60 000	160 000
Adjust for temporary differences:			
+ depreciation	140 000	140 000	40 000
- tax depreciation (20X1: 200K/ 4 years) (20X2 & 20X3: 200K/ 4 years + 500K/ 4 years)	(175 000)	(175 000)	(50 000)
Taxable profits	25 000	25 000	150 000
Tax rate	35%	45%	40%
Current tax	8 750	11 250	60 000

b) Calculation of deferred taxation using the income statement approach			
Current tax (taxable profits x 35/45/40%)	8 750	11 250	60 000
Tax expense (taxable accounting profits x 35/45/40%)	21 000	27 000	64 000
Deferred tax charge (balancing) or (temporary differences x tax rate)	12 250	15 750	4 000

Summary of deferred tax effect on deferred tax in the statement of financial position (not required)

1/1/20X1	Opening balance	0	Given
20X1	Deferred tax charge (calculation b)	4 000	Cr DT
1/1/20X2	Opening balance at 40%	4 000	Liability
	Increase in rate (4 000/ 40% x 5%)	500	Cr DT
	Opening balance restated at 45%	4 500	
20X2	Deferred tax charge (calculation b)	15 750	Cr DT
1/1/20X3	Opening balance at 45%	20 250	Liability
	Decrease in rate (20 250/ 45% x 10%)	(4 500)	Dr DT
	Opening balance restated at 35%	15 750	
20X3	Deferred tax charge (calculation b)	12 250	Cr DT
31/12/20X3	Closing balance at 35%	28 000	Liability

c) Current and deferred tax journals		20X3 Dr/ (Cr)	20X2 Dr/ (Cr)	20X1 Dr/ (Cr)
01-Jan	Tax expense	8 750	11 250	60 000
	Current tax payable (liability)	(8 750)	(11 250)	(60 000)
	Recording estimated current taxation owing			
01-Jan	Tax expense/ (income)	(4 500)	500	n/a
	Deferred tax asset/(liability)	4 500	(500)	n/a
	Recording effect of rate change on opening balance of deferred taxation			
31-Dec	Tax expense/ (income)	12 250	15 750	4 000
	Deferred tax asset/(liability)	(12 250)	(15 750)	(4 000)
	Recording current year's deferred tax charge			

Solution 6.7 continued …

Part B continued …

d) Calculation of deferred tax using the balance sheet approach

		Carrying amount	Tax base	Temporary differences	Deferred taxation	
1.1.20X1	Opening balance	0	0	0	0	
	First plant - cost	200 000	200 000	0	0	
30.6.20X1	Second plant	500 000	500 000	0	0	
	Depreciation	(40 000)	(50 000)	(10 000)	(4 000)	Dr TE Cr DT
31.12.20X1	Balance at 40%	660 000	650 000	(10 000)	(4 000)	Liability
	Rate change: 40% to 45%				(500)	Dr TE Cr DT
	Balance restated at 45%	660 000	650 000	(10 000)	(4 500)	
	Depreciation - first plant	(40 000)	(50 000)	(10 000)	(4 500)	Dr TE Cr DT
	Depreciation - second plant	(100 000)	(125 000)	(25 000)	(11 250)	Dr TE Cr DT
31.12.20X2	Balance at 45%	520 000	475 000	(45 000)	(20 250)	Liability
	Rate change: 45% to 35%				4 500	Cr TE Dr DT
	Balance restated at 35 %			(45 000)	(15 750)	
	Depreciation - first plant	(40 000)	(50 000)	(10 000)	(3 500)	Dr TE Cr DT
	Depreciation - second plant	(100 000)	(125 000)	(25 000)	(8 750)	Dr TE Cr DT
31.12.20X3	Balance at 35%	380 000	300 000	(80 000)	(28 000)	Liability

Solution 6.8

Part A

a) Statement of comprehensive income disclosure

HOBBIT LIMITED
EXTRACT FROM STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20X1

		Note	C
Profit before tax	(497 000 – 5 000 + 6 000 – 10 000 + 20 000)		508 000
Income tax expense	(147 300 – 1 200)	3	146 100
Profit for the period			361 900
Other comprehensive income			-
Total comprehensive income			361 900

b) Statement of financial position disclosure

HOBBIT LIMITED
EXTRACT FROM STATEMENT OF FINANCIAL POSITION
AT 31 DECEMBER 20X1

	Note	20X1 C	20X0 C
EQUITY AND LIABILITIES			
Non-current liabilities			
Deferred taxation	10	10 800	12 000

c) Note disclosure

HOBBIT LIMITED
EXTRACT FROM NOTES TO THE FINANCIAL STATEMEMENTS
AT 31 DECEMBER 20X1

3. Taxation			**20X1**
Normal Tax			**C**
- Current	*W1*		147 300
- Deferred			(1 200)
Income tax expense			146 100
Tax rate reconciliation		**%**	**C**
Tax effects of:			
• Profit before tax / Applicable rate	*508 000 x 30%*	30.0	152 400
• Income not subject to tax	*30 000 x 30%*	(1.8)	(9 000)
• Expenses disallowed for tax	*9 000 x 30%*	0.5	2 700
Tax expense / effective rate	*146 100/ 508 000*	28.7	146 100

The effective tax rate is lower than the applicable tax rate due to:
- Exempt income.
- Disallowed expense.

10. Deferred taxation asset/ (liability)		**20X1**	**20X0**
The deferred tax balance is caused by temporary differences relating to:		**C**	**C**
- Plant	*W3*	(10 500)	(12 000)
- Prepaid expenses	*W3*	(1 800)	0
- Income received in advance	*W3*	1 500	0
		(10 800)	(12 000)

Solution 6.8 continued …

Part A continued …

Workings

1. Normal tax computation	C	X 0.30	
Profit before tax	508 000		
Permanent differences:			
- Dividend income (not taxable)	(30 000)		
+ Fines (not deductible)	9 000		
Taxable accounting profits	487 000	146 100	Total tax expense
Temporary differences:	4 000	1 200	Cr TE Dr DT
+ Rent received in advance closing balance	5 000		
- Rates prepaid closing balance	(6 000)		
+ Depreciation (155 000 * – 120 000)	35 000		
- Tax depreciation (115 000 – 85 000)	(30 000)		
Taxable income	491 000	147 300	Dr TE Cr CTP

* where CA: 155 000 = DTL: 12 000 / 30% + TB: 115 000

3. Calculation of deferred taxation (balance sheet approach)	CA	TB	TD	DT @ 30%	
Property, plant & equipment:					
Balance – 1/1/20X1	155 000	115 000	(40 000)	(12 000)	Liability
Movement (balancing)				1 500	Dr DT Cr TE
Balance – 31/12/20X1	120 000	85 000	(35 000)	(10 500)	Liability
Rent received in advance:					
Balance – 1/1/20X1	0	0	0	0	
Movement (balancing)				1 500	Dr DT Cr TE
Balance – 31/12/20X1	(5 000)	0	5 000	1 500	Asset
Prepaid rates expense:					
Balance – 1/1/20X1	0	0	0	0	
Movement (balancing)				(1 800)	Dr TE Cr DT
Balance – 31/12/20X1	6 000	0	(6 000)	(1 800)	Liability
Advertising payable:					
Balance – 1/1/20X1	0	0	0	0	
Movement (balancing)				0	
Balance – 31/12/20X1	(10 000)	(10 000)	0	0	
Interest income receivable:					
Balance – 1/1/20X1	0	0	0	0	
Movement (balancing)				0	
Balance – 31/12/20X1	20 000	20 000	0	0	

Solution 6.8

Part B

a) Statement of comprehensive income disclosure

HOBBIT LIMITED
EXTRACT FROM STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20X1

		Note	20X1 C
Profit before tax	*(497 000 – 5 000 + 6 000 – 10 000 + 20 000)*		508 000
Taxation		3	(143 100)
Profit for the period			364 900
Other comprehensive income			-
Total comprehensive income			364 900

b) Statement of financial position disclosure

HOBBIT LIMITED
EXTRACT FROM STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 20X1

EQUITY AND LIABILITIES	**Note**	**20X1 C**	**20X0 C**
Non-current liabilities			
Deferred taxation	10	10 800	12 000

c) Note disclosure

HOBBIT LIMITED
EXTRACT FROM NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 20X1

3. Taxation		**20X1 C**
Normal tax		
- Current	*W1*	144 300
- Deferred		(1 200)
- current year temporary differences	*W3.4*	1 800
- rate change	*W3.4*	(3 000)
Income tax expense		143 100

Tax rate reconciliation		**%**	**C**
Tax effects of:			
• Profit before tax / Applicable rate	*508 000 x 30%*	30.0	152 400
• Income not subject to tax	*30 000 x 30%*	(1.8)	(9 000)
• Expenses disallowed for tax	*9 000 x 30%*	0.5	2 700
• Rate change	*Above*	(0.6)	(3 000)
Tax expense / effective rate	*143 100/ 508 000*	28.1	143 100

10. Deferred taxation asset/ (liability)		**20X1 C**	**20X0 C**
The deferred tax balance is caused by temporary differences relating to:			
- Plant	*W3.1*	(10 500)	(12 000)
- Income received in advance	*W3.2*	1 500	0
- Prepaid expenses	*W3.3*	(1 800)	0
		(10 800)	(12 000)

Solution 6.8 continued …

Part B continued …

Workings

W1. Normal tax computation		C	X 0,30	
Profit before tax	*Per SOCIE*	508 000		
Permanent differences:				
- Dividend income (not taxable)	*Given*	(30 000)		
+ Fines (not deductible)	*Given*	9 000		
Taxable accounting profits		487 000	146 100	Tax expense
Temporary differences:		(6 000)	(1 800)	Dr TE Cr DT
Add rent received in advance: c/bal		5 000		
Less rates prepaid: c/bal		(6 000)		
Add depreciation	*(145 000* – 120 000)*	25 000		
Less tax depreciation	*(115 000 – 85 000)*	(30 000)		
Taxable income		481 000	144 300	Dr TE Cr CTP

** where CA: 145 000 = DTL: 12 000 / 40% + TB: 115 000*

W3. Calculation of deferred taxation (balance sheet approach)

	CA	TB	TD	DT	
W3.1 Property, plant & equipment:					
Balance – 1/1/20X1	145 000 (2)	115 000	(30 000) (1)	(12 000)	Liability @ 40%
Rate change (decrease)				3 000	Dr DT Cr TE
Balance – 1/1/20X1 restated				(9 000)	Liability @ 30%
Movement (balancing)				(1 500)	Cr DT Dr TE
Balance – 31/12/20X1	120 000	85 000	(35 000)	(10 500)	Liability @ 30%
W3.2 Rent received in advance:					
Balance – 1/1/20X1	0	0	0	0	
Movement (balancing)				1 500	Dr DT Cr TE
Balance – 31/12/20X1	(5 000)	0	5 000	1 500	Asset @30%
W3.3 Prepaid rates expense:					
Balance – 1/1/20X1	0	0	0	0	
Movement (balancing)				(1 800)	Cr DT Dr TE
Balance – 31/12/20X1	6 000	0	(6 000)	(1 800)	Liability @ 30%
W3.4 Summary DT:	**PPE**	**IRIA**	**EPP**	**Total**	
Balance – 1/1/20X1	(12 000)	0	0	(12 000)	L
Movement: rate change			*12 000 / 40% x 10%:*	3 000	Dr DT Cr TE
Movement: other			*10 800 – (12 000 – 3000):*	(1 800)	Cr DT Dr TE
Balance – 31/12/20x1	(10 500)	1 500	(1 800)	(10 800)	L

(1) 12 000 / 40% = 30 000

(2) 115 000 + 30 000 = 145 000 (Add the temporary differences since the DT balance was a liability)

Solution 6.9

Part A

a) Calculation of deferred taxation using the balance sheet approach

	Carrying amount	Tax base	Temporary differences	Deferred taxation	
20X2 Opening balance	0	0	0	0	
Plant - cost	500 000	500 000	0	0	
Depreciation 20X2	(100 000)	(250 000)	(150 000)	(60 000)	Cr DT Dr TE
20X2 Closing balance	400 000	250 000	(150 000)	(60 000)	Liability
Depreciation 20X3	(100 000)	(150 000)	(50 000)	(20 000)	Cr DT Dr TE
20X3 Closing balance	300 000	100 000	(200 000)	(80 000)	Liability
Depreciation 20X4	(100 000)	(100 000)	0	0	
20X4 Closing balance	200 000	0	(200 000)	(80 000)	Liability
Depreciation 20X5	(100 000)	0	100 000	40 000	Dr DT Cr TE
20X5 Closing balance	100 000	0	(100 000)	(40 000)	Liability
Depreciation 20X6	(100 000)	0	100 000	40 000	Dr DT Cr TE
20X6 Closing balance	0	0	0	0	Liability

b) Calculation of taxable profits/ current tax	**20X5**	**20X4**
Profit before tax	150 000	120 000
Permanent differences	0	0
Taxable accounting profits	150 000	120 000
Temporary differences:		
+ depreciation	100 000	100 000
- tax depreciation	0	100 000
Taxable profit	250 000	120 000
Tax rate	40%	40%
Current tax	100 000	48 000

c) Journal entries	**20X6 Dr/ (Cr)**	**20X5 Dr/ (Cr)**	**20X4 Dr/ (Cr)**	**20X3 Dr/ (Cr)**	**20X2 Dr/ (Cr)**
Taxation expense		100 000	48 000		
Current tax payable (liability)	not required	(100 000)	(48 000)	not required	not required
Current normal tax estimated					
Taxation expense	(40 000)	(40 000)	N/A	20 000	60 000
Deferred taxation	40 000	40 000	N/A	(20 000)	(60 000)
Deferred tax adjustment					

Solution 6.9 continued …

Part B

a) Calculation of deferred taxation using the balance sheet approach

		Carrying amount	Tax base	Temporary differences	Deferred taxation	
20X2	Opening balance	0	0	0	0	
	Plant purchased	500 000	500 000	0	0	
	Depreciation 20X2	(100 000)	(250 000)	(150 000)	(60 000)	Cr DT Dr TE
20X2	Closing balance	400 000	250 000	(150 000)	(60 000)	Liability
	Depreciation 20X3	(100 000)	(150 000)	(50 000)	(20 000)	Cr DT Dr TE
20X3	Closing balance	300 000	100 000	(200 000)	(80 000)	Liability
	Depreciation 20X4	(100 000)	(100 000)	0	0	
20X4	Closing balance	200 000	0	(200 000)	(80 000)	Liability
	Depreciation 20X5	(100 000)	(0)	100 000	80 000	Dr DT Cr TE
	CA of asset sold	(100 000)	(0)	100 000		
20X5	Closing balance	0	0	0	0	

b) Calculation of taxable profits and current normal tax

	20X5	20X4
Profit before tax	150 000	120 000
Adjust for permanent differences	0	0
Taxable accounting profits	150 000	120 000
+ depreciation	100 000	100 000
- tax depreciation	0	(100 000)
- profit on sale (proceeds: 100 000 – CA: 100 000)	0	n/a
+profit on sale (tax)	100 000	n/a
Taxable profits	350 000	120 000
Tax rate	40%	40%
Current tax	140 000	48 000

c) Journals

		20X5 Dr/ (Cr)	20X4 Dr/ (Cr)	20X3 Dr/ (Cr)	20X2 Dr/ (Cr)
31 Dec	Taxation expense	140 000	48 000	Not required	Not required
	Current tax payable (liability)	(140 000)	(48 000)		
	Recording current tax				
31 Dec	Taxation expense	(80 000)	n/a	20 000	60 000
	Deferred tax asset/(liability)	80 000	n/a	(20 000)	(60 000)
	Recording deferred tax				

Solution 6.9 continued ….

Part B continued …

d) Disclosure

MAKE LIMITED
EXTRACT FROM STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20X5

	Note	20X5 C	20X4 C
Profit before taxation		150 000	120 000
Income tax expense	3	(60 000)	(48 000)
Profit for the period		90 000	72 000
Other comprehensive income		-	-
Total comprehensive income		90 000	72 000

MAKE LIMITED
EXTRACT FROM STATEMENT OF FINANCIAL POSITION
AT 31 DECEMBER 20X5

	20X5 C	20X4 C
ASSETS		
Non-current assets		
Property, plant and equipment	0	200 000
EQUITY AND LIABILITIES		
Non-current liabilities		
Deferred taxation	0	80 000

MAKE LIMITED
EXTRACT FROM NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 20X5

	20X5 C	20X4 C
1. Accounting Policies		

1.1 Deferred taxation

Deferred tax is provided using the balance sheet liability method, on all the temporary differences at the balance sheet date between the tax base of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax asset are recognized for all deductible temporary differences, carry forward of unused tax losses, to the extent that is probable that future taxable profit will be available against which the deductible temporary difference, unused tax losses and tax credits can be utilized.

Carrying amount of deferred tax asset is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that the related tax benefit will be realized. Deferred taxis calculated at the rates that are expected to apply to the period when differences reverse based on the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.

3. Taxation		
Normal tax		
Current tax	140 000	48 000

Deferred tax	(80 000)	0
Income tax expense	60 000	48 000

Authors' comment:
There is no rate reconciliation since there are no permanent differences or any other reconciling items. There is no permanent difference on the sale since the proceeds did not exceed the original cost.

3. Deferred tax liability

The deferred tax balance comprises temporary differences relating to:

• Property, plant and equipment	0	80 000

Solution 6.10

a)

ROOT LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 20X6

		20X6
		C
7. Tax expense	*Calculations*	
Current		
- current year	*See working 1*	80 600
- overprovision for the prior year	*48 000 – 52 000*	(4 000)
Deferred	*16 500 L + 900 A*	(17 400)
		59 200
Rate reconciliation		
Standard/ applicable tax rate		30%
Tax effect of:		
Profit before tax	*344 000 x 30%*	103 200
Dividend income taxed at lower rate	*200 000 x 30%*	(40 000)
Over-provision of current tax	*Per above*	(4 000)
		59 200
Effective tax rate	*59 200/ 344 000*	17.2%

b)

ROOT LIMITED
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER

		20X6
		C
Profit before tax		344 000
Tax	7.	59 200
Profit for the year		284 800
Other comprehensive income		-
Total comprehensive income		284 800

Solution 6.10 continued …

Workings

W1: Calculation of current normal tax		
Profit before tax		344 000
Less accounting profit on sale		(100 000)
Add taxable profit on sale		150 000
Less dividend income (to be taxed @ 10%)		(200 000)
Add depreciation		150 000
Less tax depreciation		(270 000)
Add income received in advance closing balance		130 000
Less income received in advance opening balance		(10 000)
Less expenses prepaid closing balance		(7 000)
Add expenses prepaid opening balance		15 000
Taxable profits		202 000
Current normal tax	(202 000 x 30%)	60 600
Add: Tax on dividend @ 10%	(200 000 x 10%)	20 000
		80 600

Solution 6.11

a)

	Debit	Credit
Current tax payable: NT	4 000	
Tax expense (current normal)		4 000
Over-provision of current tax expense in 20X5: given		
Tax expense (normal tax)	57 600	
Current tax payable: NT		57 600
Current normal tax payable: given		
Deferred tax: NT	17 400	
Tax expense (normal tax)		17 400
Deferred normal tax adjustment:W1		

b)

TREE LIMITED
STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 20X6

		20X6	20X5
Non-current liabilities		**C**	**C**
Deferred tax	*Given*	0	16 500
Current liabilities			
Income received in advance	*Given*	123 000	0
Current tax payable: NT	*O/bal: 6 000 – payments: 30 000 + current NT for 20X6: 57 600 – overprovision in 20X5: 4 000*	29 600	6 000
Non-current assets			
Property, plant and equipment	*Given*	150 000	1 000 000
Deferred tax	*W1*	900	0
Current assets			
Expenses prepaid	*Given*	0	5 000

TREE LIMITED
NOTES TO THE FINANCIAL STATEMENTS
AT 31 DECEMBER 20X6

8. Deferred tax asset/ (liability) note		20X6	20X5
		C	**C**
The deferred tax balance is caused by temporary differences relating to:			
Property, plant and equipment	*W1*	(36 000)	(15 000)
Income received in advance	*W1*	36 900	0
Expenses prepaid	*W1*	0	(1 500)
		900	(16 500)

Solution 6.11 continued …

Workings

W1: Deferred tax calculation

	CA	TB	TD	DT	
PPE					
O/ balance [Note 1]	1 000 000	950 000	(50 000)	(15 000)	L (16 500 – 1 500)
Movement				(21 000)	Cr DT Dr TE
C/ balance	150 000	30 000	(120 000)	(36 000)	DTL
IRIA					
O/ balance	0	0	0	0	A
Movement				36 900	Dr DT; Cr TE
C/ balance	(123 000)	0	123 000	36 900	DTA
EPP					
O/ balance	5 000	0	(5 000)	(1 500)	L
Movement				1 500	Dr DT; Cr TE
C/ balance	0	0	0	0	
Total					
O/ balance	*Given; 15 000L + 0 + 1 500L*			(16 500)	DTL
Movement	*21 000L - 36 900A – 1500A*			17 400	Dr DT Cr TE
C/ balance	*36 000L + 36 900A + 0*			900	DTA

Note 1 The opening balances for TB, TD and DT are all balancing figures, calculated as follows:

- 1st calc the o/bal of DT caused by PPE: 16 500 – 1 500 – 0 = 15 000 (credit)
- 2nd calc the related TDs: 15 000 / 30% = 50 000 (credit)
- 3rd calc the related TB of PPE using the following equation:
  TB – CA = TD; therefore:
  TB – 1 000 000 = -50 000
  TB = 1 000 000 – 50 000 = 950 000

Solution 6.12

(a)

BEAN LIMITED
STATEMENT OF FINANCIAL POSITION
AT 30 JUNE 20X7

		20X7 C	20X6 C
Non-current liabilities			
Deferred tax	W1 [X7: 52 200 (L) – 5 800 (A)]	46 400	17 400

(b)

BEAN LIMITED
STATEMENT OF FINANCIAL POSITION
AT 30 JUNE 20X7

		20X7 C	20X6 C
Current liabilities			
Current tax payable	W4	19 300	5 900

(Not required for answer)

BEAN LIMITED
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 30 JUNE 20X7

		20X7 R	20X6 R
Profit before taxation		700 000	520 000
Income tax expense	(X6: 151 900 – 8 700 – 2 900) (X7: 168 300 + 29 000 + 14 200)	(207 500)	(140 300)
Profit for the period		492 500	379 700
Other comprehensive income		-	-
Total comprehensive income		492 500	379 700

Solution 6.12 continued…

(c)

BEAN LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 20X7

1 Accounting policies

Statement of compliance

These financial statements have been prepared in accordance with the approved accounting standards as applicable in Pakistan. Approved accounting standards comprise of such International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board as are notified under the Companies Ordinance, 198, provisions of and directives issued by under the Companies Ordinance, 1984. In case the requirements differ, the provisions or directives of the Companies Ordinance, 1984 shall prevail.

Basis of preparation

The financial statements have been prepared in the historical cost basis except for the revaluation of certain non-current assets. These policies are consistent in all material respects with these applied in the previous years.

Deferred tax

Deferred tax is provided using the balance sheet liability method, on all the temporary differences at the balance sheet date between the tax base of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax asset are recognized for all deductible temporary differences, carry forward of unused tax losses, to the extent that is probable that future taxable profit will be available against which the deductible temporary difference, unused tax losses and tax credits can be utilized.

Carrying amount of deferred tax asset is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that the related tax benefit will be realized. Deferred taxis calculated at the rates that are expected to apply to the period when differences reverse based on the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.

Equipment

Plant and equipment is stated at cost less accumulated depreciation and accumulated impairment losses. Depreciation is charged so as to write off the cost of assets over their estimated useful lives using the straight line method. The estimated useful lives, depreciation methods and residual values are reviewed at each year end, with the effect of any change in estimate accounted for on a prospective basis.

		20X7 C	20X6 C
4 Taxation			
Normal tax	W2	168 300	151 900
Deferred tax	W1	29 000	(8 700)
Under / (over) provision	W3	10 200	(2 900)
Taxation expense		207 500	140 300
Tax rate reconciliation			
Tax expense on profit	(X7: 700 000 X 0.29) (X6: 520 000 X 0.29)	203 000	150 800
Dividend income exempt	(X7: 30 000 X 0.19) (X6: 40 000 X 0.19)	(5 700)	(7 600)
Under / (over) provision		10 200	(2 900)
		207 500	140 300
Effective tax rate	(X7: 207 500 / 700 000) (X6: 140 300 / 520 000)	29.64%	29.98%

Solution 6.12 continued…

(d)

BEAN LIMITED
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 30 SEPTEMBER 20X7

		C
Cash flows from operating activities		
Cash receipts from customers	(184 000 + 3 500 000 – 14 000 – 196 000)	3 474 000
Cash paid to suppliers and employees	W5	(2 929 000)
Cash generated from operations		545 000
Investment income received		30 000
Taxation paid	W4 (20 100 + 146 000)	(166 100)
Net cash inflow from operating activities		408 900

Solution 6.12 continued…

Workings

W1. Deferred tax computation

		CA	TB	TD	DT X29%	
Equipment						
01/07/X4	Cost	900 000	900 000			
30/06/X5	Depreciation / tax allowance (900 000 X 0.10) / (900 000 X 0.20)	(90 000)	(180 000)			Dr TE Cr DT 26 100
		810 000	720 000	90 000	26 100	L
30/06/X6	Depreciation / tax allowance (900 000 X 0.10) / (900 000 X 0.20)	(90 000)	(180 000)			Dr DT Cr TE 8 700
		720 000	540 000			
	Impairment	(120 000)	-			
		600 000	540 000	60 000	**17 400**	**L**
30/10/X6	Depreciation / tax allowance (600 000 / 60m X 4m) / (900 000 X 0.20)	(40 000)	(180 000)			Dr TE Cr DT 40 600
		560 000	360 000	200 000	58 000	L
	Loss on sale / Recoupment	(60 000)	140 000	(200 000)	(58 000)	Dr DT Cr TE 58 000
30/06/X7		500 000	500 000	-	-	
Expenses paid in advance						
30/06/X6	Rent paid in advance	0	0	0	0	Dr TE Cr DT 52 200
30/06/X7	Rent paid in advance (270 000 X 4/6)	180 000	0	180 000	**52 200**	**L**
Income received in advance						
30/06/X6	Rent received in advance	0	0	0	0	Dr DT Cr TE 5 800
30/06/X7	Rent received in advance	20 000	0	20 000	**5 800**	**A**

Solution 6.12 continued…

W2 Current tax computation

	20X7			20X6		
Profit before tax	700 000			520 000		
Less:						
Dividend income (to be taxed @ 10%)	(30 000)			(40 000)		
Depreciation	40 000			90 000		
Impairment				120 000		
Tax allowance	(180 000)			(180 000)		
Loss on sale	60 000					
Tax gain on sale	140 000					
Rent prepaid	(180 000)					
Rent received in advance	20 000					
	570 000	165 300	Cr CTP	510 000	147 900	Cr CTP
Dividend income	30 000	3 000		40 000	4 000	
		168 300			151 900	

W3 Under / over provision and payment with return

20X6 year		
20X5 normal assessed tax	132 200	132 200
20X5 normal tax provided / provisional payments	135 100	130 000
Overprovision / Balance owing on assessment	2 900	2 200
20X7 year		
20X6 normal assessed tax	162 100	162 100
20X6 normal tax provided / provisional payments	151 900	142 000
Underprovision / Balance owing on assessment	10 200	20 100

W4 Current tax payable

Current tax payable			
Description	***C***	***Description***	***C***
Tax expense (o/p 20X5)	2 900	Balance (01/07/X5)	5 100
Bank (Balance owing 20X5)	2 200	Tax expense (20X6)	151 900
Bank (p/p 20X6)	142 000		
Balance	9 900		
	157 000		157 000
Bank (Balance owing 20X6)	20 100	Balance (30/06/X6)	9 900
Bank (p/p 20X7)	146 000	Tax expense (u/p 20X6)	10 200
Balance	22 300	Tax expense (20X7)	168 300
	185 400		188 400
		Balance (30/06/X7)	22 300

Solution 6.12 continued…

W5. Cash paid to suppliers and employees

Sales	3 500 000
Profit before tax	700 000
COS + net expenses	2 800 000
Elimination of items shown separately on face of statement of cash flows	
Dividends received	30 000
Elimination of non-cash items	
Bad debts	(14 000)
Depreciation	(40 000)
Loss on sale of equipment	(60 000)
Elimination of the effects of accrual accounting	
Increase in inventory	125 000
Increase in accounts payable	(72 000)
Increase in expenses pre-paid	180 000
Increase in income received in advance	(20 000)
	2 929 000

Solution 6.13

a) Journals

		Debit	Credit
Tax expense	*W1*	742 350	
Current tax payable			742 350
Current normal tax estimated			
Tax expense	*W2.4*	1 650	
Deferred tax			1 650
Deferred normal tax			
Current tax payable	*Given*	5 000	
Tax expense			5 000
Overprovision of 20X1 normal tax			

b) Note disclosure

UNIVERSAL FITNESS LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 20X2

				C
4.	**Taxation**	*W1*		
	Normal tax			
	Current tax			
	• Current tax for 20X7	*W1*		742 350
	• Overprovision of current tax in 20X6	*Given*		(5 000)
	Deferred tax	*W2.6*		1 650
	Tax expense			739 000
	Tax rate reconciliation		**%**	
	Tax on profit at applicable rate	*W1: 2 350 000 X 0.30*	30	705 000
	Non-deductible donations	*20 000 X 0.30*	0.26	6 000
	Dividend income	*15 000 X 0.20*	(0.13)	(4 500)
	Exemption on administration building	*120 000 X 0.30*	1.53	36 000
	Overprovision of current tax in 20X6	*Per above*	(0.21)	(5 000)
	Tax expense		31.45	739 000

The effective tax rate is higher than the applicable tax rate due to:

- Non-deductible expenses; and

Comment: the rate reconciliation need not be provided in percentages and currency. You may choose which method to present. My suggestion would be as a currency as this is less time-consuming.

10	**Deferred tax asset or (liability)**		
	Equipment	W2.3	(79 800)
	Unearned income	W2.4	19 125
	Prepaid expenses	W2.5	(7 500)
		W2.6	(68 175)

Solution 6.13 continued …

Workings

W1 Current normal tax computation			x30%	
Profit before tax	(2 410 000 + 15 000 – 75 000)	2 350 000	705 000	
+ Donations		20 000		
+ Depreciation on administration building		120 000		
- Dividends received: to be taxed @ 10%		(15 000)		
+ Depreciation on equipment	Given	170 000		
- Tax allowance	Given	(188 000)		
- Unearned income: o/ balance	Recognised as income in 20X7, but already taxed in 20X6	(26 250)		
+ Unearned income: c/ balance	Taxable in 20X7, to be recognised as income in 20X8	63 750		
- Prepaid expenses: c/ balance	Deductible in 20X7, to be recognised as expense in 20X8	(25 000)		
Taxable income		2 469 500	740 850	Cr CTP
Dividend received to be taxed @ 10%		15 000	1 500	
			742 350	

W2 Deferred normal tax computation								
		CA		**TB**	**TD**	**DT**	
W2.1 Land							
31/12/X6		2 470 000		0	(2 470 000)	0	Exempt
		0		0	0	0	
31/12/X7		2 470 000		0	(2 470 000)	0	Exempt
W2.2 Admin buildings							
31/12/X6		1 720 000		0	(1 720 000)	0	Exempt
		(120 000)		0	120 000	0	Exempt
31/12/X7		1 600 000		0	(1 600 000)	0	Exempt
W2.3 Equipment							
31/12/X6	(1)	800 000	(2)	552 000	(248 000)	(74 400)	Liability
	(3)	(170 000)	(3)	(188 000)	(18 000)	(5 400)	Cr DT
31/12/X7	(3)	630 000	(4)	364 000	(266 000)	(79 800)	Liability
W2.4 Unearned income							
31/12/X6		(26 250)		0	26 250	7 875	Asset
						11 250	Dr DT
31/12/X7		(63 750)		0	63 750	19 125	Asset
W2.5 Prepaid expenses							
31/12/X6		0		0	0	0	
						(7 500)	Cr DT
31/12/X7		25 000		0	(25 000)	(7 500)	Liability

W2.6 Summary of deferred tax		**C**	
Proof of deferred tax at 31/12/X6 as per question	*Given or 74 400 – 7 875*	(66 525)	Liability
Deferred tax at 31/12/X7	*79 800 – 19 125 + 7 500*	(68 175)	Liability
Movement: increase in deferred tax liability	*Dr TE; Cr DT*	(1 650)	Cr DT

(1) 630 000 + 170 000 = 800 000

(2) 800 000 – 248 000 (minus because temporary differences were taxable)
(3) Given
(4) Given

Solution 6.14

a)

Journal entries

		Debit	Credit
Rent received in advance		10 000	
Rent income			10 000
Reversal of opening balance of rent received in advance			
Rent income		8 000	
Rent received in advance			8 000
Creation of closing balance of rent received in advance			
Expense account		15 000	
Expense prepaid			15 000
Reversal of opening balance of expense prepaid			
Expense prepaid		7 000	
Expense account			7 000
Creation of closing balance of expense prepaid			
Current tax payable: normal tax	*Assessed: 48 000 – Expensed: 52 000 = 4 000 overprovided*	4 000	
Tax expense (current normal)			4 000
Over-provision of current tax expense in 20X5			
Tax expense (normal tax)	*W1*	60 000	
Current tax payable: NT			60 000
Current normal tax payable			
Tax expense (normal tax)	*42 000 (A) – 22 800 (A)*	19 200	
Deferred tax: NT			19 200
Deferred normal tax adjustment			

Solution 6.14 continued …

a) continued …

W1: Current normal tax		**C**	**Tax X 30%**
Profit before tax	From the SOCI	494 000	
Less: Dividend income		(200 000)	
Permanent differences		(64 000)	
Add: Accounting gain on sale of vehicle		(100 000)	
Tax profit on sale of vehicle		150 000	
Accounting depreciation		150 000	
Less: Tax allowance		(270 000)	
Income received in advance			
Opening balance		(10 000)	
Closing balance		8 000	
Prepaid expenses			
Opening balance		15 000	
Closing balance		(7 000)	
Taxable income		230 000	69 000

Solution 6.14 continued …

b)

RAINY LIMITED
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20X6

			20X6 C
Revenue	*Sales 800 000*		800 000
Other income	*Dividend income 200 000 + Rent 50 000 + PoS 100 000 + Accruals 10 000 – 8 000*		352 000
Cost of sales			(300 000)
Distribution costs	*150 000 + (80 000 – 7 000 + 15 000) x 30%*		(176 400)
Administration costs	*(80 000 – 7 000 + 15 000) x 20%*		(17 600)
Other costs	*(80 000 – 7 000 + 15 000) x 50%*		(44 000)
Finance costs	*Given*		(120 000)
Profit before tax			494 000
Tax		7.	(77 700)
Profit for the year			416 300
Other comprehensive income			-
Total comprehensive income			416 300

c)

RAINY LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 20X6

7. Tax expense note		**20X6 C**
Normal tax		
Current		
- current year	*W1 (in part a)*	69 000
- overprovision for the prior year	*52 000 – 48 000; or per the journal*	(4 000)
Deferred	*42 000A – 22 800A; or per the journal*	19 200
		84 200

Rate reconciliation

Standard/ applicable tax rate		30%
Tax effect of:		
Profit before tax	*494 000 x 30%*	148 200
Exempt dividend income	*200 000 x 30%*	(60 000)
Over-provision of current tax	*Per above*	(4 000)
		84 200
Effective tax rate	*84 200 / 494 000*	17.04%

Solution 6.15

W1. Calculation of current normal tax	20X3	20X2	20X1
	C	C	C
Profit before tax	30 000	20 000	14 000
Dividend Income	(10 000)	(10 000)	(10 000)
Temporary differences (PPE)	(8 000)	(4 000)	(14 000)
Assessed tax loss brought forward	(4 000)	(10 000)	0
Taxable profit/ (tax loss)	8 000	(4 000)	(10 000)
Current normal tax at 30%	2 400	0	0
Add: Tax on dividend income @ 10% (10 000 x 10%)	1 000	1 000	1 000
	3 400	1 000	1 000

W2. Calculation of deferred normal tax

	Carrying amount (SOFP) (a)	Tax base (IAS 12) (b)	Temporary difference (b) – (a) (c)	Deferred tax at 30% (c) x 30% (d)	Deferred tax balance/ adjustment
W2.1 PPE					
Balance: 1 Jan 20X1	70 000	90 000	20 000	6 000	Asset
Movement	(6 000)	(20 000)	(14 000)	(4 200)	Cr DT Dr TE
Balance: 31 Dec 20X1	64 000	70 000	6 000	1 800	Asset
Movement	(16 000)	(20 000)	(4 000)	(1 200)	Cr DT Dr TE
Balance: 31 Dec 20X2	48 000	50 000	2 000	600	Asset
Movement	(12 000)	(20 000)	(8 000)	(2 400)	Cr DT Dr TE
Balance: 31 Dec 20X3	36 000	30 000	(6 000)	(1 800)	Liability
W2.2 Tax loss					
Balance: 1 Jan 20X1	0	0	0	0	
Movement				3 000	Dr. DT Cr. TE
Balance: 31 Dec 20X1	0	10 000	10 000	3 000	Asset
Movement	0			(1 800)	Cr. DT Dr. TE
Balance: 31 Dec 20X2	0	4 000	4 000	1 200	Asset
Movement	0			(1 200)	Cr. DT Dr. TE
Balance: 31 Dec 20X3	0	0	0	0	

W2.3 Summary of deferred tax on:	PPE	Tax loss	Total	
Balance: 1 January 20X1	6 000	0	6 000	
Movement	(4 200)	3 000	(1 200)	Cr. DT Dr. TE
Balance: 31 December 20X1	1 800	3 000	4 800	Asset
Movement	(1 200)	(1 800)	(3 000)	Cr. DT Dr. TE
Balance: 31 December 20X2	600	1 200	1 800	Asset
Movement	(2 400)	(1 200)	(3 600)	Cr. DT Dr. TE
Balance: 31 December 20X3	(1 800)	0	(1 800)	Liability

Solution 6.15 continued ...

Journals 20X1		**Debit**	**Credit**
Tax expense	*W2.1*	4 200	
Deferred tax: NT – PPE (L)			4 200
Deferred tax adjustment due to temporary differences PPE (20X1)			
Deferred tax: NT – loss (A)	*W2.2*	3 000	
Tax expense: NT			3 000
Deferred tax adjustment due to tax loss created (20X1)			
Tax Expense		1 000	
Current tax payable			1 000
Current normal tax payable 20X1			
Journals 20X2			
Tax expense: NT	*W2.1*	1 200	
Deferred tax: NT – PPE (L)			1 200
Deferred tax adjustment due to temporary differences: PPE (20X2)			
Tax expense: NT	*W2.2*	1 800	
Deferred tax: NT – loss (A)			1 800
Deferred tax adjustment due to tax loss partially utilised (20X2)			
Tax Expense		1 000	
Current tax payable			1 000
Current normal tax payable 20X2			
Journals 20X3			
Tax expense: NT	*W2.2*	2 400	
Deferred tax: NT – PPE (L)			2 400
Deferred tax adjustment due to temporary differences: PPE (20X3)			
Tax expense: NT	*W2.2*	1 200	
Deferred tax: NT – loss (A)			1 200
Deferred tax adjustment: remaining tax loss utilised (20X3)			
Tax expense: NT	*W1*	3 400	
Current tax payable: NT			3 400
Current normal tax payable 20X3			

Liquid limited
Notes to the financial statements
For the year ended 31 December 20X3

3. Taxation expense		**20X3 C**	**20X2 C**	**20X1 C**
Normal taxation expense				
• Current	*W1*	3 400	1 000	1 000
• Deferred	*W2.3*	3 600	3 000	1 200
• Tax loss (created)/ used		1 200	1 800	(3 000)
• Other temporary differences		2 400	1 200	4 200
		7 000	4 000	2 200
Tax rate reconciliation				
Applicable tax rate		30%	30%	30%
Tax effects of:				
Profit/ (loss) before tax	*(20X3: 30 000 x 30%) (20X2: 20 000 x 30%) (20X1: 14 000 x 30%)*	9 000	6 000	4 200
Permanent differences	*(20X1 - 20X3: 10 000 x 20%)*	(2 000)	(2 000)	(2 000)
Tax expense per the statement of comprehensive income		7 000	4 000	2 200

Effective tax rate	*(20X3: 7 000/ 30 000) (20X2: 4 000/ 20 000) (20X1: 2 200 / 14 000)*	23.33%	20.00%	15.71%

5. Deferred tax asset/ (liability)

The deferred tax balance comprises tax on the following types of temporary differences:

• Property, plant and equipment	*W2.3*	(1800)	600	1 800
• Tax loss	*W2.3*	0	1 200	3 000
		(1 800)	1 800	4 800

Solution 6.16

This is the solution to the question as it stands in the book (i.e. no DTA is to be recognised at all)

W1. Calculation of current normal tax	20X3	20X2	20X1
	C	C	C
Profit before tax	30 000	20 000	14 000
Less: Dividend income	(10 000)	(10 000)	(10 000)
Less: Temporary differences (PPE)	(8 000)	(4 000)	(14 000)
Assessed tax loss brought forward	(4 000)	(10 000)	0
Taxable profit/ (tax loss)	8 000	(4 000)	(10 000)
Current normal tax at 30%	2 400	0	0
Add: Tax on dividend income @ 10%	1 000	1 000	1 000
	3 400	1 000	1 000

W2. Calculation of deferred normal tax

	Carrying amount (SOFP) (a)	Tax base (IAS 12) (b)	Temporary difference (b) – (a) (c)	Deferred tax at 30% (c) x 30% (d)	Deferred tax balance/ adjustment
W2.1 PPE					
Balance: 1 Jan 20X1	70 000	90 000	20 000	6 000	Asset
Movement	(6 000)	(20 000)	(14 000)	(4 200)	Cr DT Dr TE
Balance: 31 Dec 20X1	64 000	70 000	6 000	1 800	Asset
Movement	(16 000)	(20 000)	(4 000)	(1 200)	Cr DT Dr TE
Balance: 31 Dec 20X2	48 000	50 000	2 000	600	Asset
Movement	(12 000)	(20 000)	(8 000)	(2 400)	Cr DT Dr TE
Balance: 31 Dec 20X3	36 000	30 000	(6 000)	(1 800)	Liability
W2.2 Tax loss					
Balance: 1 Jan 20X1	0	0	0	0	
Movement				3 000	Dr DT Cr TE
Balance: 31 Dec 20X1	0	10 000	10 000	3 000	Asset
Movement	0			(1 800)	Cr DT Dr TE
Balance: 31 Dec 20X2	0	4 000	4 000	1 200	Asset
Movement	0			(1 200)	Cr DT Dr TE
Balance: 31 Dec 20X3	0	0	0	0	

W2.3 Summary	PPE			Tax loss			Total		
	Total (a)	Recognised (b)	Unrecognised (c)	Total (d)	Recognised (e)	Unrecognised (f)	Total (g)	Recognised (h)	Unrecognised (i)
O/ balance 20X1	6 000	0	6 000	0	0	0	6 000		6 000
Movement	(4 200)	0	(4 200)	3 000	0	3 000	(1 200)		(1 200)
C/ balance 20X1	1 800	0	1 800	3 000	0	3 000	4 800		4 800
Movement	(1 200)	0	(1 200)	(1 800)	0	(1 800)	(3 000)		(3 000)
C/ balance 20X2	600	0	600	1 200	0	1 200	1 800		1 800
Movement	(2 400)	(1 800)	(600)	(1 200)	0	(1 200)	(3 600)	(1 800)	(1 800)
C/ balance 20X3	(1 800)	(1 800)	0	0	0	0	(1 800)	(1 800)	0

Please note: when the unrecognised portion of a DTA is reduced (see columns c and f), this means that some of what was previously unrecognised is now recognised (i.e. see column c: 6 000 DTA relating to PPE was initially not recognised, but by the end of 20X1, the portion that was unrecognised was only 1 800: this therefore means that 4 200 was recognised – see journals).

Solution 6.16 continued …

Journals 20X1		**Debit**	**Credit**
Tax expense	*W2.1*	4 200	
Deferred tax			4 200
DTA reversed due to temporary differences reversing: PPE (20X1) NOTE 1			
Deferred tax	*W2.3: column (c)*	4 200	
Tax expense			4 200
DTA recognised now that it was used (i.e. reversed – jnl above): PPE (20X1)			
Deferred tax : tax loss	*W2.2*	3 000	
Tax expense			3 000
DTA created: tax loss created (20X1)			
Tax expense	*W2.3: column (f)*	3 000	
Deferred tax: tax loss			3 000
DTA not to be recognised: reversal of above entry: tax loss (20X1)			
Tax expense		1 000	
Current tax payable			1 000
Current tax payable 20X1			
Journals 20X2			
Tax expense	*W2.1*	1 200	
Deferred tax			1 200
DTA reversed due to temporary differences reversing: PPE (20X2) NOTE 1			
Deferred tax	*W2.3: column (c)*	1 200	
Tax expense			1 200
DTA recognised now that it was used (i.e. reversed – jnl above): PPE (20X2)			
Tax expense	*W2.2*	1 800	
Deferred tax			1 800
DTA reduces due to tax loss partially used (20X2) NOTE 1			
Deferred tax : tax loss	*W2.3: column (f)*	1 800	
Tax expense			1 800
DTA recognised now that it was used (i.e. jnl above): tax loss (20X2)			
Tax expense		1 000	
Current tax payable			1 000
Current tax payable 20X2			
Journals 20X3			
Tax expense	*W2.1*	2 400	
Deferred tax			2 400
DTA reversed and a DTL created due to temporary differences reversing: PPE (20X3) NOTE 1			
Deferred tax	*W2.3: column (c)*	600	
Tax expense			600
DTA recognised now that it was used (i.e. the remaining previously unrecognised asset of 600 reversed – included in jnl above): PPE (20X3)			
Tax expense	*W2.2*	1 200	
Deferred tax			1 200
DTA reduces due to remaining tax loss being used (20X3) NOTE 1			
Deferred tax : tax loss	*W2.3: column (f)*	1 200	
Tax expense			1 200
DTA recognised now that it was used (i.e. jnl above): tax loss (20X3)			
Tax expense	*W1*	3 400	

Current tax payable	3 400
Current tax payable 20X3	

NOTE 1: The journal is processed showing that a DTA asset was reversed (see W2.1 & W2.2). The problem is that since the company did not want to recognise deferred tax assets, the original 6 000 DTA on PPE and the original 3 000 DTA on the tax loss that are reversed were *not recognised* in the first place! This is the reason for the next journals where the part of the DTA that is reversing is now quickly recognised. The effect is nil on the balances, but these journals are necessary since disclosure of this movement is required.

Solution 6.16 continued …

Reflection Limited
Notes to the financial statements
For the year ended 31 December 20X3

15. Taxation expense		**20X3 C**	**20X2 C**	**20X1 C**
Normal taxation				
• Current		3 400	1 000	1 000
• Deferred		1 800	0	0
- Temporary differences – current year	*Jnls*	2 400	1 200	4 200
- Tax loss – current year (arose)/ used	*Jnls*	1 200	1 800	(3 000)
- Current year DTA *not* recognised: tax loss [12.81 (e)]	*Jnls*	0	0	3 000
- Prior year unrecognised DTA now recognised:				
- Tax loss (because used) [12.80 (e)]	*Jnls*	(1 200)	(1 800)	0
- Temporary differences (because reversed) [12.80 (e)]	*Jnls*	(600)	(1 200)	(4 200)
Tax expense per the statement of comprehensive income		5 200	1 000	1 000
Tax rate reconciliation				
Applicable tax rate		30%	30%	30%
Tax effects of:				
Profit before tax	*(20X3: 30 000 x 30%)* *(20X2: 20 000 x 30%)* *(20X1: 14 000 x 30%)*	9 000	6 000	4 200
Permanent differences	*(20X1 - 20X3: 10 000 x 20%)*	(2 000)	(2 000)	(2 000)
Current year DTA not recognised: tax loss [12.81 (e)]	*Per above*	0	0	3 000
Prior year unrecognised DTA now recognised:				
- Tax loss (because used) [12.80 (e)]	*Per above*	(1 200)	(1 800)	0
- Temporary differences (because reversed) [12.80 (e)]	*Per above*	(600)	(1 200)	(4 200)
Tax expense per the statement of comprehensive income		5 200	1 000	1 000
Effective tax rate	*(5 200 / 30 000, 1 000 / 20 000, 1 000 / 14 000)*	17.33%	5.00%	7.14%

5. Deferred tax asset/ (liability)

The deferred tax balance comprises tax on the following types of temporary differences:

• Property, plant and equipment	W2.3	(1 800)	0	0
• Tax loss	W2.3	0	0	0
		(1 800)	0	0

Solution 6.16 ADAPTED

ADAPTATION: the question is adapted as follows:

- there is insufficient evidence for Reflection Limited to realise deferred tax assets created by its tax losses, although deferred tax assets on deductible temporary differences may be recognised.

W1. Calculation of current normal tax	**20X3**	**20X2**	**20X1**
	C	**C**	**C**
Profit before tax	30 000	20 000	14 000
Less: Dividend to be taxed @10%	(10 000)	(10 000)	(10 000)
Temporary differences (PPE)	(8 000)	(4 000)	(14 000)
Assessed tax loss brought forward	(4 000)	(10 000)	0
Taxable profit/ (tax loss)	8 000	(4 000)	(10 000)
Current normal tax at 30%	2 400	0	0
Tax on dividend income @10%	1 000	1 000	1 000

W2. Calculation of deferred normal tax

	Carrying amount (SOFP) (a)	**Tax base (IAS 12) (b)**	**Temporary difference (b) – (a) (c)**	**Deferred tax at 30% (c) x 30% (d)**	**Deferred tax balance/ adjustment**
W2.1 PPE					
Balance: 1 Jan 20X1	70 000	90 000	20 000	6 000	Asset
Movement	(6 000)	(20 000)	(14 000)	(4 200)	Cr DT Dr TE
Balance: 31 Dec 20X1	64 000	70 000	6 000	1 800	Asset
Movement	(16 000)	(20 000)	(4 000)	(1 200)	Cr DT Dr TE
Balance: 31 Dec 20X2	48 000	50 000	2 000	600	Asset
Movement	(12 000)	(20 000)	(8 000)	(2 400)	Cr DT Dr TE
Balance: 31 Dec 20X3	36 000	30 000	(6 000)	(1 800)	Liability
W2.2 Tax loss					
Balance: 1 Jan 20X1	0	0	0	0	
Movement				3 000	Dr DT Cr TE
Balance: 31 Dec 20X1	0	10 000	10 000	3 000	Asset
Movement	0			(1 800)	Cr DT Dr TE
Balance: 31 Dec 20X2	0	4 000	4 000	1 200	Asset
Movement	0			(1 200)	Cr DT Dr TE
Balance: 31 Dec 20X3	0	0	0	0	

W2.3 Summary	**PPE**			**Tax loss**			**Total**		
	Total	**Recognised**	**Unrecognised**	**Total**	**Recognised**	**Unrecognised**	**Total**	**Recognised**	**Unrecognised**
	(a)	**(b)**	**(c)**	**(d)**	**(e)**	**(f)**	**(g)**	**(h)**	**(i)**
O/ balance 20X1	6 000	6 000	0	0	0	0	6 000	6 000	0
Movement	(4 200)	(4 200)	0	3 000	0	3 000	(1 200)	(4 200)	3 000
C/ balance 20X1	1 800	1 800	0	3 000	0	3 000	4 800	1 800	3 000
Movement	(1 200)	(1 200)	0	(1 800)	0	(1 800)	(3 000)	(1 200)	(1 800)
C/ balance 20X2	600	600	0	1 200	0	1 200	1 800	600	1 200
Movement	(2 400)	(2 400)	0	(1 200)	0	(1 200)	(3 600)	(2 400)	(1 200)
C/ balance 20X3	(1 800)	(1 800)	0	0	0	0	(1 800)	(1 800)	0

Solution 6.16 ADAPTED continued …

Journals 20X1		**Debit**	**Credit**
Tax expense	*W2.1*	4 200	
Deferred tax			4 200
DTA reversed due to temporary differences reversing: PPE (20X1)			
Deferred tax : tax loss	*W2.2*	3 000	
Tax expense			3 000
DTA created: tax loss created (20X1)			
Tax expense	*W2.3: column (f)*	3 000	
Deferred tax: tax loss			3 000
DTA not to be recognised: reversal of above entry: tax loss (20X1)			
Tax expense		1 000	
Current tax payable			1 000
Current tax payable 20X1			
Journals 20X2			
Tax expense	*W2.1*	1 200	
Deferred tax			1 200
DTA reversed due to temporary differences reversing: PPE (20X2)			
Tax expense	*W2.2*	1 800	
Deferred tax			1 800
DTA reduces due to tax loss partially used (20X2) NOTE 1			
Deferred tax : tax loss	*W2.3: column (f)*	1 800	
Tax expense			1 800
DTA recognised now that it was used (i.e. jnl above): tax loss (20X2)			
Tax expense		1 000	
Current tax payable			1 000
Current tax payable 20X2			
Journals 20X3			
Tax expense	*W2.1*	2 400	
Deferred tax			2 400
DTA reversed and a DTL created due to deductible temporary differences reversing and taxable temporary differences arising: PPE (20X3)			
Tax expense	*W2.2*	1 200	
Deferred tax			1 200
DTA reduces due to remaining tax loss being used (20X3) NOTE 1			
Deferred tax : tax loss	*W2.3: column (f)*	1 200	
Tax expense			1 200
DTA recognised now that it was used (i.e. jnl above): tax loss (20X3)			
Tax expense	*W1*	3 400	
Current tax payable			3 400
Current tax payable 20X3			

NOTE 1: The journal is processed showing that a DTA asset was reversed (see W2.1 & W2.2). The problem is that since the company did not want to recognise deferred tax assets on the tax loss, the parts of the original 3 000 DTA on the tax loss that are reversed were *not recognised* in the first place! This is the reason for the next journals where the part of the DTA that is reversing is now quickly recognised. The effect is nil on the balances, but these journals are necessary since disclosure of this movement is required.

Solution 6.16 ADAPTED continued …

Reflection Limited
Notes to the financial statements
For the year ended 31 December 20X3

15. Taxation expense		**20X3 C**	**20X2 C**	**20X1 C**
Normal taxation				
• Current		2 400	1 000	1 000
• Deferred		2 400	1 200	4 200
- Temporary differences – current year	*Jnls*	2 400	1 200	4 200
- Tax loss – current year (arose)/ used	*Jnls*	1 200	1 800	(3 000)
- Current year DTA *not* recognised: tax loss [12.81 (e)]	*Jnls*	0	0	3 000
- Prior year unrecognised DTA now recognised:				
- Tax loss now used [12.80 (e)]	*Jnls*	(1 200)	(1 800)	0
Tax expense per the statement of comprehensive income		5 800	2 200	5 200
Tax rate reconciliation				
Applicable tax rate		30%	30%	30%
Tax effects of:				
Profit before tax *(20X3: 30 000 x 30%)* *(20X2: 20 000 x 30%)* *(20X1: 14 000 x 30%)*		9 000	6 000	4 200
Permanent differences *(20X1 - 20X3: 10 000 x 20%)*		(2 000)	(2 000)	(2 000)
Current year DTA not recognised: tax loss [12.81 (e)]	*Per above*	0	0	3 000
Prior year unrecognised DTA now recognised:				
- Tax loss [12.80 (e)]	*Per above*	(1 200)	(1 800)	0
Tax expense per the statement of comprehensive income		5 800	2 200	5 200
Effective tax rate *(20X3: 5 800 / 30 000)* *(20X2: 2 200 / 20 000)* *(20X1: 5 200 / 14 000)*		19.33%	11.00%	37.14%

5. Deferred tax asset/ (liability)

The deferred tax balance comprises tax on the following types of temporary differences:

• Property, plant and equipment	*W2.3 column b*	(1 800)	600	1 800
• Tax loss	*W2.3 column e*	0	0	0
	W2.3 column h	(1 800)	600	1 800

Solution 6.17

W1. Calculation of current normal tax	20X3	20X2	20X1
	C	C	C
Profit before tax	(20 000)	(10 000)	10 000
Less: Dividend income (to be taxed as a separate block of income)	(20 000)	(20 000)	(20 000)
Assessed tax loss brought forward	(140 000)	(110 000)	(100 000)
Taxable profit/ (tax loss)	(180 000)	(140 000)	(110 000)
Current normal tax at 30%	0	0	0
Tax on dividend @ 10%	2 000	2 000	2 000
Total current tax	2 000	2 000	2 000

	Carrying amount (SOFP) (a)	Tax base (IAS 12) (b)	Temporary difference (b) – (a) (c)	Deferred tax at 30% (c) x 30% (d)	Deferred tax balance/ adjustment
W2.1 Tax loss					
Balance: 1 Jan 20X1	0	0	100 000	30 000	Asset
Movement				3 000	Dr.DT CR.TE
Balance: 31 Dec 20X1	0	110 000	110 000	33 000	Asset
Movement	0			9 000	Dr.DT Cr. TE
Balance: 31 Dec 20X2	0	140 000	140 000	42 000	Asset
Movement	0			12 000	Dr.DT Cr. TE
Balance: 31 Dec 20X3	0	180 000	180 000	54 000	Asset

W2.2 Summary	Other temporary differences			Tax loss			Total		
	Total (a)	Recognised (b)	Unrecognised (c)	Total (d)	Recognised (e)	Unrecognised (f)	Total (g)	Recognised (h)	Unrecognised (i)
O/ balance 20X1	0	0	0	30 000	30 000	0	30 000	30 000	0
Movement	0	0	0	3 000	3 000	0	3 000	3 000	0
C/ balance 20X1	0	0	0	33 000	33 000	0	33 000	33 000	0
Derecognise (1)					(33 000)	33 000		(33 000)	33 000
Movement	0	0	0	9 000	0	9 000	9 000	0	9 000
C/ balance 20X2	0	0	0	42 000	0	42 000	42 000	0	42 000
Re-recognise (2)					33 000	(33 000)		33 000	(33 000)
Recognise (3)					9 000	(9 000)		9 000	(9 000)
Movement	0	0	0	12 000	12 000	0	12 000	12 000	0
C/ balance 20X3	0	0	0	54 000	0	0	54 000	0	0

(1) Write-down of an asset – derecognising the asset
(2) Write-back of an asset – re-recognising the asset that was derecognised in a prior year
(3) Recognising a deferred tax asset that had not been recognised before

Solution 6.17 continued ...

Journals		**20X3**	**20X2**	**20X1**
Deferred tax : tax loss	*W2.1*	12 000	9 000	3 000
Tax expense		(12 000)	(9 000)	(3 000)
Deferred tax adjustment: tax loss created				
Tax expense	*W2.2*	0	33 000	0
Deferred tax: tax loss		0	(33 000)	0
Write-down of prior year DTA since future profitability is now in question (only in 20X2)				
Tax expense	*W2.2*	0	9 000	0
Deferred tax: tax loss		0	(9 000)	0
DTA reversed: Current year deferred tax asset is not to be recognised since profitability is in question (only in 20X2)				
Deferred tax : tax loss	*W2.2*	33 000	0	0
Tax expense		(33 000)	0	0
Write back of previously written down DTA: sufficient profitability is now expected such that the tax loss will be able to be used				
Deferred tax: tax loss	*W2.2*	9 000	0	0
Tax expense		(9 000)	0	0
Prior year DTA now recognised for the first time: sufficient profitability is now expected such that the tax loss will be able to be used				
Current tax		2 000	2 000	2 000
Current tax payable		(2 000)	(2 000)	(2 000)
Current tax payable for the years20X1, 20X2 and 20X3				

Solution 6.17 continued...

Beans Limited
Notes to the financial statements
For the year ended 31 December 20X3

15. Taxation expense		**20X3 C**	**20X2 C**	**20X1 C**
Normal taxation				
• Current		2 000	2 000	2 000
• Deferred		(54 000)	33 000	(3 000)
- Temporary differences – current year [80 (c)]	*Jnls*	0	0	0
- Tax loss – current year	*Jnls*	(12 000)	(9 000)	(3 000)
- Current year DTA not recognised:			9 000	
- Tax loss [81 (e)]				
- Prior year recognised DTA written down/(back):	*Jnls*	(33 000)	33 000	0
- Tax loss [80 (g)]				
- Prior year unrecognised DTA now recognised:		(9 000)	0	0
- Tax loss [80 (f)]				
		(52 000)	35 000	(1 000)
Tax rate reconciliation				
Applicable tax rate		30%	30%	30%
Tax effects of:				
Profit before tax	*(20 000 x 30%)*	(6 000)	(3 000)	3 000
	(10 000 x 30%)			
	(10 000 profit x 30%)			
Permanent differences	*20 000 x 20% (each year)*	(4 000)	(4 000)	(4 000)
Current year deferred tax asset not recognised:				
- Tax loss [81 (e)]	*Per above*	0	9 000	0
Prior year recognised DTA written down/(written back):				
- Tax loss [80 (g)]	*Per above*	(33 000)	33 000	0
Prior year unrecognised deferred tax asset now recognised:				
- Tax loss [80 (f)]	*Per above*	(9 000)	0	0
Tax expense per the statement of comprehensive income		(52 000)	35 000	(1 000)
Effective tax rate	*(52 000 tax income / 20 000 loss)*	260%	-350%	-10%
	(35 000 expense / 10 000 loss)			
	(1 000 tax income / 10 000 profit)			

5. Deferred tax asset/ (liability)

The deferred tax balance comprises tax on the following types of temporary differences:

• Tax loss	54 000	0	33 000
	54 000	0	33 000

Solution 6.18 ADAPTED

Adaptation:
This question has been adapted by adding the following requirements:
c) Calculate the total tax expense recognised in 20X8
d) Calculate the adjustment to the deferred tax liability account caused by temporary differences arising in 20X8.
e) Calculate the adjustment to the deferred tax liability account caused by the rate change.
f) Calculate the total deferred tax expense recognised in 20X8.
g) Calculate the total tax expense recognised in 20X8.
h) List the items that would appear as reconciling items in the tax expense note's rate reconciliation.

a) Deferred tax balance

W1.1 PPE	CA	TB	TD	DT	
Balance: 1/1/20X8 (at 29%)	700 000	680 000	(20 000)	(5 800)	L
Rate change (1)				(200)	Cr DT Dr TE
Balance: 1/1/20X8 (at 30%)				(6 000)	
Building: sold	(120 000)	(130 000)	(10 000)	(3 000)	Cr DT Dr TE
Plant: revaluation surplus (2)	10 000	0	(10 000)	(3 000)	Cr DT Dr RS
Plant: depreciation (3) (4)	(12 000)	(0)	12 000	3 600	Dr DT Cr TE
Other: depreciation (given)	(50 000)	(35 000)	15 000	4 500	Cr DT Dr TE
Balance: 31/12/20X8	528 000	515 000	(13 000)	(3 900)	L

(1): 5 800 / 29% x 1% = 200 (increase in the balance)
(2): FV: 60 000 – CA: 50 000 = 10 000
(3): FV: 60 000 / RUL: 5 years = 12 000
(4): Tax deductions on plant are nil: a nil tax base means that 100% of the cost has already been deducted

W2 Expense prepaid	CA	TB	TD	DT	
Balance: 1/1/20X8 (at 29%)	0	0	0	0	
Rate change				0	
Balance: 1/1/20X8 (at 30%)					
Movement	30 000	0	(30 000)	(9 000)	Cr DT Dr TE
Balance: 31/12/20X8	30 000	0	(30 000)	(9 000)	L

W3 Deferred tax balance A/(L)	PPE	Expense Prepaid	Total	
Balance: 1/1/20X8 (at 29%)	(5 800)	0	(5 800)	L
Rate change	(200)	0	(200)	Cr DT Dr TE
Revaluation surplus	(3 000)	0	(3 000)	Cr DT Dr RS
Other temporary differences	5 100	(9 000)	(3 900)	Cr DT Dr TE
Balance: 31/12/20X8	(3 900)	(9 000)	(12 900)	L

Solution 6.18 ADAPTED continued ...

b) Current normal tax calculation

Current taxation (and deferred taxation adjustment)			**30%**	
Profit before tax	*Given*	650 000		
Permanent differences:				
Less Dividend income (to be taxed as separate lock of income)		(20 000)		
Temporary differences:				
Add depreciation	*50 000 + (50 000 + 10 000) / 5*	62 000		
Less tax depreciation	*Given*	(35 000)		
Add loss on sale	*SP ltd to CP: 100 000 – CA: 120 000*	20 000		
Less scrapping allowance	*SP ltd to CP: 100 000 – TB: 130 000*	(30 000)		
Less expenses prepaid c/ balance	*Given*	(30 000)		
Taxable profit and current normal tax		617 000	185 100	Dr TE Cr CTP
Add: Dividend income to be taxed @ 10%		20 000	2 000	
Total current tax			187 100	

c) Current normal tax expense recognised

Current tax for current year	*(b) above*	187 100
Current tax for prior year - overprovided		(6 500)
• Assessed tax: 20X7	*650 000 x 29%*	188 500
• Estimated current tax: 20X7	*Given*	195 000
Total current normal tax expense		180 600

d) Deferred tax adjustment due to temporary differences arising in 20X8

Deferred tax adjustments on temporary differences arising in 20X8, recognised in:

• Other comprehensive income	*Cr DT Dr RS: working (a)*	3 000
• Profit or loss	*Cr DT Dr TE: working (a)*	3 900
Total adjustment to the DTL account due to 20X8 temporary differences arising in 20X8		6 900

e) Deferred tax adjustment due to rate change (temp. differences arising *before* 20X8)

Deferred tax rate change adjustment recognised in:

• Other comprehensive income	*N/A: no opening balance reval surplus*	0
• Profit or loss	*Cr DT Dr TE: working (a)*	200

f) Deferred tax expense recognised

Deferred tax *expense* (i.e. only those adjustments recognised in *profit or loss*), due to:

• Temporary differences arising in 20X8	*Working (d) above: Cr DT Dr TE:*	3 900
• Rate change (prior temporary differences)	*Working (e) above: Cr DT Dr TE:*	200

Solution 6.18 ADAPTED continued ...

g) Tax expense

Normal tax		
Current		180 600
• Current year	*Working (b) above: Dr TE Cr CTP*	187 100
• Prior year overprovision	*Working (c) above: Cr TE Dr CTP*	(6 500)
Deferred		4 100
• Current year temporary differences	*Working (d) above: Dr TE Cr DT*	3 900
• Rate change (prior year td's)	*Working (e) above: Dr TE Cr DT*	200
Secondary tax		0
Tax expense (on face of statement of comprehensive income)		184 700

h) Reconciling items

The items that would cause the effective rate of tax to differ from the standard rate of tax include:

• Dividend income	*20 000 x 20%*	4 000
• Rate change		200
• Overprovision		(6 500)

Solution 6.19

a)

Part A: Journals

Date	Account names	Debit	Credit
1 Jan X4	Revenue received in advance: 1 Jan 20X4	5 000	
	Revenue from services		5 000
	Reversal of opening balance of revenue received in advance		
1 Jan X4	Rent expense	20 000	
	Rent expense prepaid: 1 Jan 20X4		20 000
	Reversal of opening balance of rent expense prepaid		
31 Dec X4	Revenue from services	15 000	
	Revenue received in advance: 31 Dec 20X4		15 000
	The recognition of revenue received in advance deferred to future years		
31 Dec X4	Rent expense prepaid: 31 Dec 20X4	30 000	
	Rent expense		30 000
	The recognition of rent prepaid as an expense is deferred to future years		
29 Dec X4	Dividend declared	20 000	
	Dividends payable		20 000
	Final dividend declared on 29 December 20X4		

Note to student: you would now need to calculate profit before tax (you should normally do this as part of your SOCI to save you time later: no SOCI was asked for in this question so it was done as a working instead). After doing this, calculate taxable profits and current normal tax. Only then are you able to do the tax journals.

31 Dec X4	Tax expense	W1	333 500	
	Current tax payable: normal tax			333 500
	Current normal tax estimated for 20X4			
31 Dec X4	Tax expense *Assessment: 120 000 - Expensed: 110 000*		10 000	
	Current tax payable: normal tax			10 000
	Current normal tax in 20X3 was underprovided			
31 Dec X4	Tax expense	W3.4	29 250	
	Deferred tax: normal tax			29 250
	Increase in opening balance of deferred normal tax - rate changed from 30% to 40%			
31 Dec X4	Deferred tax: normal tax	W3.4	1 000	
	Tax expense			1 000
	Adjustment of deferred tax balance owing to current year movement in temporary differences			

Solution 6.19 continued …

W1 Current normal tax calculation

Profit before tax	*W4*	810 000
Less: dividend income (taxed @ 10%)	*Given*	(5 000)
Add: donations made	*Given*	25 000
Less: accounting profit on sale	*Given*	(25 000)
Add: taxable gain	*Given*	7 500
Less: income received in advance (O/B)	*Given*	(5 000)
Add: income received in advance (C/B)	*Given*	15 000
Add: rent expense prepaid (C/B)	*Given*	20 000
Less: rent expense prepaid (O/B)	*Given*	(30 000)
Add: depreciation	*Given*	50 000
Less: tax depreciation	*Given*	(30 000)
Taxable profit		832 500
Current normal tax	*(832 500 X 40%)*	333 000
Tax on dividend income @ 10%	*(5 000 X 10%)*	500
		333 500

W3. Deferred tax calculation:			**Carrying amount**		**Tax base**	**Temporary difference**	**Deferred tax bal/ adj**	
W3.1 Income received in advance								
01/01/X8	Balance		(5000)		0	5 000	1500	A
	Rate change (30% - 40%)						500	
	Movement		(10 000)		0	10 000	4 000	
31/12/X8	Balance		(15 000)		0	15 000	6 000	A
W3.2 Rent expense prepaid								
01/01/X8	Balance		20 000		0	(20 000)	(6 000)	L
	Rate change (30% - 40%)						(2 000)	
	Movement		10 000		0	(10 000)	(4 000)	
01/01/X8	Balance		30 000		0	(30 000)	(12 000)	L
W3.3 Property, plant and equipment								
01/01/X8	Balance (work backwards)		1 155 000		877 500	(277 500)	(83 250)	L
	Rate change (30% - 40%)						(27 750)	
	Depreciation/tax depreciation	(1)	(50 000)	(1)	(30 000)	20 000	8 000	
	Sale of plant: carrying amt	(1)	(30 000)	(2)	(47 500)	(17 500)	(7 000)	
01/01/X8	Balance		1 075 000		800 000	(275 000)	(110 000)	L

(1) Given
(2) W5

W3.4 Summary

Opening balance (1 500 – 6 000 – 83 250)		(87 750)	L
Rate change (500 – 2 000 – 27 750)	Cr DT Dr TE	(29 250)	
Movement (4 000 – 4 000 + 8 000 – 7 000)	Dr DT Cr TE	1 000	
Closing balance (6 000 – 12 000 – 110 000)		(116 000)	L

W4 Profit before tax

Revenue from services	*(1 510 000 + Accrual adjustments: 5 000 – 15 000)*	1 500 000
Dividend income		5 000

Solution 6.19 continued …

Profit on sale of plant		25 000
Depreciation		(50 000)
Donations		(25 000)
Finance charges		(55 000)
Other expenses	*(600 000 + Accrual adjustments: 20 000 – 30 000)*	(590 000)
Profit before tax		810 000

W5	**Tax base of plant sold**		
	Proceeds	*CA: 30 000 + PoS: 25 000*	55 000
	Less: capital profit	*Given*	(7 500)
	Tax base		47 500

Solution 6.20

SOZORSTED LIMITED
STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 20X4

		Notes	20X4 C
ASSETS			
Non current assets			
Property, plant and equipment	*W3.1*		1 075 000
Current assets			
Inventory	*Given*		400 000
Debtors	*Given*		30 000
Expenses prepaid	*20 000 – 20 000 + 30 000*		30 000
			1535 000
LIABILITIES AND EQUITY			
Equity			
Issued share capital and reserves	*Per SOCIE*		1 073 500
Non current liabilities			
Deferred tax	*W 3.4*	15	87 000
Loan liabilities	*Total liabilities 150 000 – 20X3 DT: 132 000*		18 000
Current liabilities			
Creditors	*Given*		40 000
Income received in advance	*5 000 -5 000 + 15 000*		15 000
Dividends payable	*Per journal: final dividend declared but unpaid*		20 000
Current tax payable: normal tax			271 500
Bank overdraft	*Given*		10 000
			1 535 000

SOZORSTED LIMITED
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 20X4

		Share Capital C	Retained Earnings C	Total C
Opening balance	*Given*	200 000	320 000	520 000
Total comprehensive income	*Per SOCI*		583 500	583 500
Less dividend declared	*10 000 + 20 000*		(30 000)	(30 000)
Closing balance		200 000	873 500	1 073 500

SOZORSTED LIMITED
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20X4

		Notes	20X4 C
Revenue	*1 510 000 + Accrual adj's: 5 000 – 15 000*		1 500 000
Add: other income	*(25 000 + 5 000)*		30 000
Less: expenses	*50 000 + 25 000 + 600 000 + Accrual adj's: 20 000 – 30 000*		(665 000)
Less: finance costs			(55 000)
Profit before tax		10	810 000
Less taxation	*Tax note*	11	(266 500)
Profit for the year			583 500
Other comprehensive income			0
Total comprehensive income			583 500

Solution 6.20 continued …

SOZORSTED LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 20X4

		20X4 C
10. Profit before tax		
Profit before tax is stated after taking into account the following disclosable items:		
- Depreciation on plant	50 000	
11. Tax expense		
Normal tax		
- Current		271 500
- current year	*W 1*	261 500
- prior year under/ (over) provision	*(1)*	10 000
- Deferred		(45 000)
- Current year movement	*W 3.4*	(12 000)
- Rate change on prior year balance	*W 3.4*	(33 000)
Tax expense on face of statement of comprehensive income		266 500

(1): Assessment for 20X3: 120 000 – Estimated provision in 20X3: 110 000

Rate reconciliation

Standard tax rate		30%
Tax effect of:		
Profit before tax	*810 000 x 30%*	243 000
Less exempt dividend income	*5 000 x 20%*	(1 000)
Add non-deductible donation	*25 000 x 30%*	7 500
Current tax: prior year under-provision	*Per above*	10 000
Deferred tax: rate change	*Per above*	(33 000)
Tax expense on face of statement of comprehensive income		226 500
Effective tax rate	*226 5005 / 810 000*	27.96 %

15. Deferred tax asset / (liability)		**20X4**	**20X3**
The deferred tax balance is caused by the following		**C**	**C**
• Property, plant and equipment	W 3.1	(82 500)	(126 000)
• Income received in advance	W 3.2	4 500	2 000
• Expenses prepaid	W 3.3	(9 000)	(8 000)
		(87 000)	(132 000)

Solution 6.20 continued …

Workings

W1 Current normal tax	Calculations	20X4 C
Profit before tax	*Per SOCI*	810 000
Less dividend income (to be treated as a separate block of income)	*Given*	(5 000)
Less: accounting profit on sale		(25 000)
Add: tax profit on sale		45 000
Add non deductible donations	*Given*	25 000
Add income received in advance (c/bal)	*Given*	15 000
Less income received in advance (o/bal)	*Given*	(5 000)
Less expenses prepaid (c/bal)	*Given*	(30 000)
Add expenses prepaid (o/bal)	*Given*	20 000
Add depreciation	*Given*	50 000
Less tax depreciation	*Given*	(30 000)
Taxable profits		870 000
Current normal tax	*Taxable profit x 30%*	261 000
Add: Tax on dividend income @10%	*(5 000 x 0.1)*	500
Total current tax		261 500

Solution 6.20 continued …

Workings continued …

W 3 Deferred tax	CA	TB	TD	DT	
W3.1 Property, plant and equipment					
Opening balance (balancing)	1 155 000	840 000	(315 000)	(126 000)	*L @ 40%*
Purchases (cost)	0	0			
Sales (carrying amount)	(30 000)	(10 000)			
Depreciation/ tax depreciation	(50 000)	(30 000)			
Closing balance	1 075 000	800 000	(275 000)	(82 500)	*L @ 30%*
W3.2 Income received in advance					
Opening balance	(5 000)	0	5 000	2 000	*A @ 40%*
Movement					
Closing balance	(15 000)	0	15 000	4 500	*A @ 30%*
W3.3 Expenses prepaid					
Opening balance	20 000	0	(20 000)	(8 000)	*L @ 40%*
Movement					
Closing balance	30 000	0	(30 000)	(9 000)	*L @ 30%*

W3.4 Summary	PPE	IRIA	EPP	Total	
Opening balance at 40%	(126 000)	2 000	(8 000)	(132 000)	*L*
Rate change (rate decreased)	Debit DT; Credit TE	*132 000/ 40% x 10%*		33 000	
Opening balance restated 30%				(99 000)	
Current year movement in TD's	Debit DT; Credit TE	*99 000 – 87 000*		12 000	
Closing balance 30%	(82 500)	4 500	(9 000)	(87 000)	*L*